

DODGE & COX

September 30, 2008

# Income Fund

Ticker Symbol

DODIX

## Objective

- The Fund seeks a high and stable rate of current income, consistent with long-term preservation of capital. A secondary objective is to take advantage of opportunities to realize capital appreciation.

## Strategy

- The Fund invests in a diversified portfolio consisting primarily of high-quality bonds and other fixed income securities, including U.S. government obligations, mortgage and asset-backed securities, corporate bonds, collateralized mortgage obligations (CMOs) and others rated A or better by either S&P or Moody's. To a lesser extent, the Fund may also invest in fixed income securities rated Baa/BBB, or lower, by Moody's/S&P.

The proportions held in the various fixed income securities will be revised in light of Dodge & Cox's appraisal of the economy, the relative yields of securities in the various market sectors, the investment prospects for issuers and other factors. In selecting securities, Dodge & Cox will consider many factors, including yield to maturity, quality, liquidity, call risk, current yield and capital appreciation potential.

## GENERAL INFORMATION

Net Asset Value Per Share	\$11.58
Total Net Assets (billions)	\$14.9
30-Day SEC Yield <sup>(a)</sup>	6.84%
Expense Ratio (1/1/08 to 6/30/08, annualized)	0.44%
Portfolio Turnover Rate (1/1/08 to 6/30/08, unannualized)	10%
Fund Inception	1989
<i>No sales charges or distribution fees</i>	

**Investment Manager:** Dodge & Cox, San Francisco. Managed by the Fixed Income Investment Policy Committee, whose nine members' average tenure at Dodge & Cox is 15 years.

## PORTFOLIO CHARACTERISTICS

	Fund	LBAG
Number of Fixed Income Securities	478	9,420
Effective Maturity (years)	6.2	7.1
Effective Duration (years)	3.8	4.5

## FIVE LARGEST CORPORATE ISSUERS<sup>(c)</sup>

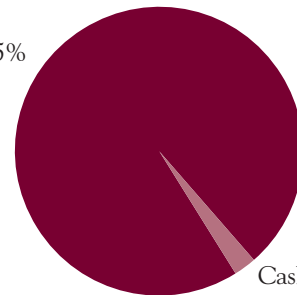
	Fund
Ford Motor Credit Co.	2.5%
HCA, Inc.	2.5
Wachovia Corp.	2.3
Time Warner, Inc.	2.1
Xerox Corp.	1.9

## CREDIT QUALITY<sup>(d)</sup>

	Fund	LBAG
U.S. Government & Government Related	57.9%	72.5%
Aaa	2.4	7.9
Aa	6.4	4.3
A	7.5	8.2
Baa	13.8	7.1
Ba	2.2	0.0
B	4.8	0.0
Caa	2.5	0.0
Cash Equivalents	2.5	0.0
Average Quality	Aa2	Aa1

## ASSET ALLOCATION

Fixed Income  
Securities: 97.5%



Cash  
Equivalents: 2.5%

## SECTOR DIVERSIFICATION

	Fund	LBAG
U.S. Treasury & Government Related	8.0%	32.6%
Mortgage-Related Securities	50.0	40.1
Asset-Backed Securities/CMBS <sup>(b)</sup>	2.2	5.3
Corporate	37.3	18.0
Non-Corporate Yankee	0.0	4.0
Cash Equivalents	2.5	0.0

## MATURITY DIVERSIFICATION

	Fund	LBAG
0-1 Years to Maturity	8.1%	0.0%
1-5	39.9	41.3
5-10	42.8	46.6
10-15	1.0	4.3
15-20	1.0	1.9
20-25	5.4	2.2
25 and Over	1.8	3.7

<sup>(a)</sup> SEC yield is an annualization of the Fund's total net investment income per share for the 30-day period ended on the last day of the month.

<sup>(b)</sup> CMBS refers to commercial mortgage-backed securities, which are a component of the LBAG but not currently held by the Fund.

<sup>(c)</sup> The Fund's portfolio holdings are subject to change without notice. The mention of specific securities is not a recommendation or solicitation for any person to buy, sell or hold any particular security.

<sup>(d)</sup> The Fund's credit quality ratings are from Moody's Investor Services. If no Moody's rating is available, the Standard & Poor's rating is reported. If unrated, the investment manager determines a comparable rating. The LBAG's credit quality ratings are from Lehman Brothers and reference Moody's, Standard & Poor's and Fitch ratings. The LBAG's methodology for calculating average credit quality differs from that used by the Fund. Applying the LBAG methodology, the Fund's average credit quality would be Aa3. The credit quality of the investments in the portfolio does not apply to the stability or safety of the Fund or its shares.

## Average Annual Total Return

For periods ended  
September 30, 2008

	1 Year	3 Years	5 Years	10 Years
Dodge & Cox Income Fund	-2.26%	2.26%	2.58%	4.89%
LBAG Index	3.66	4.15	3.79	5.20

[www.dodgeandcox.com](http://www.dodgeandcox.com)

The Dodge & Cox Income Fund had a total return of negative 3.8% for the third quarter of 2008, compared to negative 0.5% for the Lehman Brothers Aggregate Bond Index (LBAG). At quarter end, the Fund had net assets of \$14.9 billion with a cash position of 2.5%.

### MARKET COMMENTARY

A slowing economy, falling housing market and eroding confidence in the financial sector intensified the year-old credit crisis and led to a series of extraordinary events in September, starting with the U.S. government placing the mortgage giants Fannie Mae and Freddie Mac into conservatorship. Days later the government denied aid to ailing investment bank Lehman Brothers, which was forced to declare bankruptcy. This prompted a hurried sale of Merrill Lynch to Bank of America and a swift decision by Goldman Sachs and Morgan Stanley to convert to bank holding companies. The U.S. government provided insurance leader American International Group (AIG) with a secured \$85 billion loan in exchange for an 80% equity stake. It also orchestrated sales of two large commercial banks: Washington Mutual's assets were purchased by JPMorgan Chase, and three days later Citigroup announced it would take over the bulk of Wachovia's assets and liabilities. (After quarter end, Wells Fargo announced it would acquire all of Wachovia: a takeover battle ensued, and it appears Wells Fargo has prevailed.) Recognizing the need for a broader, systemic solution, the U.S. Treasury Department and Federal Reserve proposed the Troubled Asset Relief Program to use up to \$700 billion of public funds to buy troubled mortgage (and other) assets from financial institutions with U.S. operations.

The effect of these events on financial markets was dramatic: equity markets tumbled, credit markets encountered extreme turbulence and the short-term debt markets seized. In the latter case, short-term interbank lending dried up, and the overnight LIBOR rate (a benchmark of confidence within the banking system) spiked to an all-time high of 6.88% at quarter end. The commercial paper market, the primary avenue for large non-bank companies to access short-term funds for operating purposes, was crimped by isolated incidents of distress in money market funds—typically the largest purchasers of this short-term corporate debt. Only the U.S. Treasury and Government-Sponsored Enterprise Mortgage-Backed Securities (GSE MBS) sectors posted positive returns for the quarter and, in both cases, these returns were relatively modest.

There were preliminary signs of these credit market problems causing growing distress in the “real” (non-financial) economy: U.S. macroeconomic conditions deteriorated throughout the quarter as home prices continued to decline, the labor market worsened (unemployment rate over 6%; 300,000 jobs lost) and consumer spending stagnated. In particular, auto sales experienced a precipitous decline. Relief was visible only in a broad retreat in oil prices (from \$145 a barrel intra-quarter to \$100 as of quarter end) and a resilient export sector.

### THIRD QUARTER PERFORMANCE REVIEW

The Fund lagged the LBAG by 3.3% for the third quarter.

#### KEY DETRACTORS FROM RELATIVE RESULTS:

- The Fund's significant Corporate sector overweight (19.7 percentage points greater than the LBAG at the beginning of the quarter) detracted from relative returns as the Corporate sector underperformed comparable-duration<sup>1</sup> Treasuries by an unprecedented 10.3% for the quarter.
- Several Corporate holdings performed extremely poorly including AIG (purchased during the quarter), GMAC, SLM Corp. and Kaupthing Bank. (After quarter end, Kaupthing Bank sought protection under the Icelandic Financial Supervisory Authority, which has appointed a winding-up committee. The bonds are illiquid and trade at distressed levels.)
- The Fund's significant underweight of the U.S. Treasury sector hindered returns.

#### KEY CONTRIBUTORS TO RELATIVE RESULTS:

- The Fund's GSE MBS holdings performed relatively well.

- The Fund's yield advantage over the LBAG (1.2 percentage points greater than the LBAG at the beginning of the quarter) benefited relative returns.

### INVESTMENT STRATEGY

The Fund's disappointing recent results reflect the difficulties of navigating an environment where substantial market moves are driven by fear and uncertainty rather than an appraisal of long-term investment fundamentals. Though it is clear the current environment is unique in its depth, severity and velocity, Dodge & Cox has managed investments through challenging periods in the past, successfully applying our time-tested investment approach to find long-term opportunities arising from short-term uncertainties. We have every confidence this approach will see the Fund through the current distress as well.

The Fund is positioned as of quarter end with a significant 60.5% weighting in GSE MBS, U.S. Treasuries and Agencies and cash, which have minimal credit risk. The vast majority of this exposure is in GSE MBS, where we believe attractive yields and solid cash flows make a good investment opportunity.

The current environment has affected the Corporate sector most deeply, particularly financial institutions. Even healthy corporations are being challenged from two sides: financing their businesses amidst a severe credit crunch and facing the growing prospects of a difficult macroeconomic operating environment. Nevertheless, the magnitude of the market movement—the price of U.S. investment grade corporate debt fell, on average, by 8.3 percentage points in September alone—strikes us as an exaggerated response to these challenges.

We believe that the fear and uncertainty currently gripping the credit markets mask the long-term prospects for the Fund's Corporate holdings (37.3% of the Fund at quarter end), and we see opportunities to benefit from this disconnect. We have maintained the Fund's Corporate bond positioning through this period and sought out new opportunities as well. We have also continued our regular monitoring of the Fund's Corporate holdings. Specifically, we have focused recent efforts on analyzing companies' near-term liquidity, their access to funding in this stressed environment, and their potential vulnerability to rating agency downgrades.

### CLOSING

Although predicting the short-term direction of financial markets is impossible, decades of experience have taught us that periods of uncertainty often present some of the best long-term investment opportunities. We believe our investment approach—based on a three-to-five year time frame and a thorough understanding of an investment's fundamentals in relation to its valuation—is critical in navigating the current uncertain market environment. We encourage our shareholders to take a similar long-term view.

For further review of the Fund's performance and long-term investment strategy, please visit [www.dodgeandcox.com](http://www.dodgeandcox.com) and download the Fund's Third Quarter Report, which will be available in November.

October 2008

<sup>1</sup> Duration is a measure of a bond's price sensitivity to changes in interest rates.

**Past performance does not guarantee future results.** Investment return and share price will fluctuate with market conditions, and investors may have a gain or loss when shares are sold. Mutual fund performance changes over time and currently may be significantly lower than stated above. Performance is updated and published monthly. Visit the Fund's web site at [www.dodgeandcox.com](http://www.dodgeandcox.com) or call 800-621-3979 for current performance figures.

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The LBAG is a widely-recognized, unmanaged index of U.S. dollar-denominated investment-grade fixed-income securities. The Fund's total returns include the reinvestment of dividend and capital gain distributions, but have not been adjusted for any income taxes payable by shareholders on these distributions. Index returns include interest income and, unlike Fund returns, do not reflect fees or expenses.

You should carefully consider the Fund's investment objectives, management fees, risks and expenses before investing. To obtain a Fund's prospectus which contains this and other important information visit [www.dodgeandcox.com](http://www.dodgeandcox.com) or call (800) 621-3979. Please carefully read the prospectus before investing.